



State of California  
**Franchise Tax Board**

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Date: 05.31.11

Technical Advice Memorandum: 2011-04

Requested By: Ron Maddox and Diane Deatherage  
Requested Dates: June 10, 2010; December 6, 2010; and December 12, 2010  
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SUBJECT: Exempt Organization Processing, Billing, Suspension and Revivor

**QUESTIONS PRESENTED AND ANSWERS**

Ron Maddox and Diane Deatherage from the Exempt Organizations Unit submitted questions in writing to the Legal Division on June 10, 2010 and December 6, 2010. Additional questions were raised at a meeting between members of the Exempt Organizations Unit and the Legal Division on December 12, 2010. The questions are stated below with summary answers for convenience, with more specific discussion in the "Analysis and Discussion" section below:

1. May the Franchise Tax Board (FTB) grant an exemption from California franchise or income tax retroactively into years in which there are no financial records available to be submitted?

Answer: Yes. As with filing enforcement determinations and other audit adjustments, FTB will consider all available documentation in making the determination. If the normal records were lost or destroyed, FTB may exercise judgment to determine what supporting documentation is sufficient.

2. In lieu of financial records or statements, may FTB accept a signed statement of a duly elected officer or board member attesting to the fact the entity did not have gross receipts normally exceeding \$25,000 for certain years? This includes years during which no financial records are available and no returns were filed.

Answer: Yes. This is one possible method that FTB could use to establish entitlement to exemption from California franchise or income tax where no objective documentation is available. As with all situations where documentation is not available, FTB should exercise

discretion and not mechanically accept a statement or other documentation where there is any indication that it might be falsified or fraudulent.

3. May FTB revive a corporation from suspension before required tax returns or exempt organization returns are filed for all years the corporation was in existence or qualified in California?

Answer: No. A return for each tax period that the corporation was suspended must be submitted with the revivor request. Where the organization does not have access to complete financial records, the organization should estimate the return figures from available information.

4. Must FTB require payment of all taxes, interest, penalties, and fees for all exempt taxable years before revivor can occur and issuance of an exemption determination is made under California Revenue and Taxation Code section 23701 et seq.?

Answer: No. FTB may consider the exemption simultaneously with the revivor to determine the correct amount of tax, penalty, interest, and fees due for the suspension period that must be paid to revive.

5. Must FTB require payment of all taxes, interest, penalties, and fees for all non-exempt taxable years before revivor can occur and issuance of an exemption determination is made under California Revenue and Taxation Code section 23701 et seq.?

Answer: No. If FTB determines that revivor without full payment will improve the prospects for collection of the full amount due, FTB may revive the entity without full payment.<sup>1</sup>

6. If an organization files California Corporation Franchise or Income Tax Returns (Form 100) for taxable years 2006-2010, and it files either a California Exemption Application (Form 3500) or a California Submission of Exemption Request (Form 3500A) in 2010, which FTB grants in 2010 but retroactively to 2006, would FTB require the organization to file California Exempt Organization Annual Information Returns (Form 199) for taxable years 2006-2010 and pay Form 199 filing fees? In this fact pattern, assume the organization has gross receipts normally greater than \$25,000. Would it make a difference if the organization paid Minimum Franchise Tax (MFT) or no tax with its Form 100's? In this fact pattern, also assume that the returns are all within the statute of limitations for refunds.

Answer: No. As the Form 100 had substantially all of the information that the Form 199 has, generally there is no reason to make the organization file the Form 199's for the prior years; however, FTB could ask for it if there is a business need. As to the payments, the entity would get a credit for whatever payments it had made with the Form 100's for each

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<sup>1</sup> Rev. & Tax. Code § 23305b.

year, so unless the Form 199 fee is more than previously paid each year, there would be no remaining amount due.

7. Where a corporation that has not established that it qualifies for exemption from California franchise or income tax erroneously files an exempt organization return, should FTB issue a Return Information Notice (RIN) or a Notice of Proposed Assessment (NPA)?

Answer: The MFT is due and payable by operation of law and so is by definition not a deficiency and can be assessed by a RIN or by other notice and demand such as a Notice of Tax Due (NTD). However, tax in excess of the MFT based on the gross receipts shown on the Form 199 would have to be estimated as a deficiency, and must be issued on an NPA.

### **APPLICABLE LAW**

California Corporations Code section 2205(c) provides that a suspended corporation's corporate powers, rights, and privileges may not be exercised, except for the purposes of filing an application for exemption or amending the articles of incorporation as necessary either to perfect the exemption application or to set forth a new name.

California Revenue and Taxation Code section 23153(a) provides that every corporation described in subdivision (b) shall be subject to the MFT from the earlier of the date of incorporation, qualification, or commencing to do business within this state, until the effective date of dissolution or withdrawal, or if later, the date the corporation ceases to do business within the limits of this state.

California Revenue and Taxation Code section 19025(a) provides that at least the MFT is due and payable by operation of law on or before the 15<sup>th</sup> day of the 4<sup>th</sup> month of the taxable year.<sup>2</sup>

California Revenue and Taxation Code section 19051 provides that any amount of tax in excess of that disclosed on a return, due to a mathematical error, notice of which has been mailed to the taxpayer, is not a deficiency assessment, and the taxpayer has no right of protest or appeal based on that notice.

California Revenue and Taxation Code section 23305 provides a process for the revivor of suspended or forfeited corporations, which includes the filing of all past due returns and payments of all amounts due. Section 23305b provides an exception to the full payment of all amounts due requirement, allowing FTB to revive a corporation to good standing without full payment of all amounts due if it determines that the revivor will improve the prospects for collection of the full amount due. The revivor may be limited in time and/or scope, and the corporate powers, rights, and privileges may again be suspended or forfeited if the FTB determines that the prospects for collection of the full amount due have not been improved by the revivor of the corporation.

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<sup>2</sup> *Appeal of Napp Systems (USA) Inc.*, 86-SBE-030, February 4, 1986.

California Revenue and Taxation Code section 23772 sets forth annual information return filing requirements for certain exempt organizations.

California Revenue and Taxation Code section 23775 provides for the suspension or forfeiture of exempt organizations for failure to file the annual return or statement required under sections 23772 or 23774, or pay any amount due under sections 23703 or 23772 on or before the last day of the 12<sup>th</sup> month following the close of the taxable year.

California Revenue and Taxation Code section 23776 provides specialized procedures for revivor of entities suspended or forfeited pursuant to section 23775, including the requirement to file any returns, statements, notifications, or amounts due under sections 23772, 23774 or 23775, which were not previously submitted or paid and resulted in the suspension or forfeiture.

California Revenue and Taxation Code section 23701 provides that certain organizations are exempt from tax if they submit an application for exemption in the form prescribed by FTB, pay a filing fee, and FTB issues a determination exempting the organization from tax. This determination can be retroactive to the extent the organization established it satisfied the exemption requirements during each of the prior years requested.

California Revenue and Taxation Code section 23701d(c)(1)(A) provides that organizations organized and operated for nonprofit purposes in accordance with this section are exempt from tax if they submit a copy of the determination letter or ruling issued by the Internal Revenue Service recognizing the organization's exemption from federal income tax under Internal Revenue Code section 501(a), as an organization described in section 501(c)(3).<sup>3</sup>

California Code of Regulations, title 18, section 19032 provides audit procedures, including the taxpayer's duty to maintain records, and explains that the auditor and the taxpayer or the taxpayer's representative should work together to make information requests relevant and reasonable including the use of alternative sources of information in order to substantiate the facts and circumstances of the issue under audit.

California Code of Regulations, title 18, section 23701(g) provides that every exempt organization shall make its records available or shall submit, in addition to its annual information return or statement, such additional information as may be required by FTB for the purpose of enabling it to inquire further into the organization's exempt status and to administer the provisions of Chapter 4 of the Corporation Tax Law.

*West Publishing Co. v. McColgan* (1946) 27 Cal.2d 705 held that where a taxpayer was unable or unwilling to produce documentation, FTB can make a reasonable estimate of income using information available.

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<sup>3</sup> FTB Notice 2008-3, *AB 897 Implementation – Issuance of Exempt Acknowledgment Letter*, May 30, 2008.

Technical Advice Memorandum (TAM) 2004-53, *Assessment Procedures – Entities Filing Tax Exempt Returns*, September 1, 2004, held that FTB does not have authority to issue a summary assessment, which is due and payable on notice and demand, where an entity that has not established that it qualifies for exemption from California franchise or income tax, incorrectly files an exempt organization return because the error (of filing the exempt organization return) is not discernable from the face of the return. It should be noted that this TAM was issued before the online Exempt Organizations List was made available as a public record on FTB's website<sup>4</sup>, and did not specifically address the assessment of MFT.

## **ANALYSIS AND DISCUSSION**

The first two questions address the issue of the burden of proof that an entity must meet to establish entitlement to exemption from California franchise or income tax for prior years. As a general rule, FTB has broad authority to request information or documentation to establish the proper tax liability, and in the absence of records, may estimate liability using any available information.<sup>5</sup> Each case has different facts, so there is no bright-line test for the sufficiency of documentation required to establish exemption. In some cases, a signed statement from a duly elected officer or board member would be enough, in others it might not. Therefore, in some cases, FTB may grant an exemption from California franchise or income tax retroactively into years in which there are no financial records where the taxpayer provides a signed statement attesting to the appropriate facts.

Questions three, four, and five relate to the revivor process for a suspended corporation that seeks to establish exempt status. As a general rule, a suspended corporation can only perform the acts necessary to revive, including the filing of an exemption application (Form 3500) or exemption request (Form 3500A).<sup>6</sup> Especially where the entity has failed to file returns, the balance due on the account of a suspended corporation is often derived from estimated assessments, and the normal practice is to allow the corporation to file the delinquent returns, and if those returns are accepted and processed, to reduce the amount that must be paid to revive based on those returns. There does not appear to be any reason to treat exempt taxpayers differently. If the taxpayer can show it is entitled to exemption from California franchise or income tax, then the exemption application (Form 3500) or exemption request (Form 3500A) should be considered in determining the amount of tax properly due from the taxpayer to revive.

Because California Revenue and Taxation Code section 23305 provides that all past due returns must be filed before revivor, FTB cannot revive a corporation without receiving past due returns. In determining the correct amount of tax that must be paid for revivor under section 23305, or whether FTB should restore the corporation to good standing without full payment under section 23305b, staff should take into account the results of the exemption determination under section 23701 et seq.

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<sup>4</sup> See [http://www.ftb.ca.gov/businesses/Exempt\\_organizations/Entity\\_list.shtml](http://www.ftb.ca.gov/businesses/Exempt_organizations/Entity_list.shtml).

<sup>5</sup> *West Publishing Co. v. McColgan* (1946) 27 Cal.2d 705; Cal. Code Regs., tit. 18, § 19032.

<sup>6</sup> Corp. Code § 2205(c).

Question six relates to an organization that has previously filed Form 100's in prior years and now it files an exemption application (Form 3500) or exemption request (Form 3500A) in the current year. In this fact pattern, FTB grants exemption retroactively to the organization back to the date of its formation. And, in this fact pattern, we will assume the organization has gross receipts normally greater than \$25,000. Additionally, we will also assume that the returns are all within the statute of limitations for refunds. The question is whether the organization should be required to file Form 199's for the years it had previously filed Form 100's and pay Form 199 filing fees. And, a follow-up question is whether it would make a difference if the organization paid the MFT or no tax with its Form 100's. Where the Form 100's had substantially all of the information that the Form 199's have, there is no legal requirement that the organization also file the Form 199's for the prior years; however, FTB could ask that the Form 199's be filed if there is a business need. As to the payments, they would get a credit for whatever payments they had made with the Form 100's for each year, so unless the Form 199 fee is more than previously paid each year, there would be no remaining amount due.

Therefore, for purposes of revivor, if the entity has filed Form 100's, it is not necessary to require them to re-file Form 199's for those prior years.

Question seven asks whether a summary assessment (issued by RIN or NTD) can be issued rather than a deficiency assessment (i.e., NPA) where a corporation that has not obtained exemption from California franchise or income tax incorrectly files an exempt organization return. In 2004, TAM 2004-53 held that an NPA was required. However, as a corporation is not entitled to file an exempt organization return until an exemption from California franchise or income tax has been obtained under California Revenue and Taxation Code section 23701 et seq., the use of the wrong return form and consequent failure to self-assess and remit the MFT is a mathematical or clerical error which can be assessed by a RIN or NTD under California Revenue and Taxation Code section 19051. That notice should clearly explain the reason for the assessment and provide the taxpayer with instructions on how to seek exempt status (via filing Form 3500 or Form 3500A), or how to proceed if the taxpayer believes an exemption from California franchise or income tax has already been obtained from FTB.

Furthermore, TAM 2004-53 did not discuss the assessment of the MFT as a due and payable non-deficiency amount. The MFT vests on the first day of the taxable year that a corporation is in existence or doing business in California, and becomes due and payable on the first estimated tax installment due date under California Revenue and Taxation Code section 19025(a). Due and payable amounts are not deficiencies and may be assessed by notice and demand.

Because the holding of TAM 2004-53 is now inconsistent with these conclusions, it is superseded and withdrawn. However, an increase to measured tax based on undeterminable or unreported taxable income is a deficiency and so must be assessed on an NPA. So where a taxpayer reports only gross receipts on a Form 199, FTB must issue an NPA to estimate taxable income and propose resulting additional tax.

### **EFFECT ON PREVIOUS DOCUMENTS**

Technical Advice Memorandum, 2004-53, *Assessment Procedures – Entities Filing Tax Exempt Returns*, September 1, 2004, is superseded and withdrawn by this document.

### **DRAFTING INFORMATION**

The principal author of this memorandum is Adam Susz, Tax Counsel III, General Tax Law Bureau; with assistance from Greg Heninger, Program Spec. I, Tax Administration & Procedure Bureau; and Bruce Langston, Tax Counsel IV, Technical Resources Bureau.